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IN THE SUPREME COURT OF THE UNITED STATES

October Term 1994

HOPEWELL COGENERATION LIMITED PARTNERSHIP, *et al.*,

Petitioners,

V.

STATE CORPORATION COMMISSION,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Virginia

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Section 210 of the Public Utility Regulatory Policies Act of 1978 [hereinafter PURPA] and implementing regulations established a national policy for the encouragement of electric power generation by non-utilities using more efficient technologies or alternative fuels by requiring utilities to purchase power from them at rates based on the utilities' avoided costs. The result has been a proliferation of non-utility sources of power generation and competition in the wholesale power markets which benefits all consumers of electric power in the United States.

The question presented for review is whether a state may, consistent with the Supremacy Clause, invoke principles of state utility law to thwart this federal policy by retroactively disapproving utility payments under existing contracts that are based on avoided costs estimated at the time of contracting, as permitted by PURPA and implementing regulations?

LIST OF PARTIES AND RULE 29.1 STATEMENT

The following is a list of parties to the cases below. In addition, Chesapeake Paper Products Company and Virginia Electric and Power Company (a subsidiary of Dominion Resources, Inc.) had companion cases to the Petitioners' cases below.

A. Petitioners:

1) Hopewell Cogeneration Limited Partnership

The parents of Hopewell Cogeneration Limited Partnership's partners are CRSS Inc., National Power, P.L.C., (a corporation organized under the laws of England and Wales) and SCEcorp. A planned merger has been announced between CRSS Inc. and an indirect subsidiary of Powerfin S.A. (a publicly traded corporation organized under the laws of Belgium), which is, in turn, controlled by Tractebel S.A. (also a publicly traded corporation organized under the laws of Belgium). Upon completion of the merger, CRSS Inc. will become an indirect subsidiary of Powerfin S.A. Hopewell Cogeneration Limited Partnership has no subsidiaries.

2) Appomattox Cogeneration Limited Partnership

The parents of Appomattox Cogeneration Limited Partnership's partners are CRSS Inc. and Central Vermont Public Service Corp. Appomattox Cogeneration Limited Partnership has no subsidiaries.

3) Cogentrix Virginia Leasing Corporation

Cogentrix Virginia Leasing Corporation's parent company is Cogentrix Energy, Inc. Cogentrix Virginia Leasing Corporation has no subsidiaries.

4) Enron-Richmond Power Corp.

Enron-Richmond Power Corp.'s parent company is Enron Corp. Enron-Richmond Power Corp. is a partner in Richmond Power Enterprise, L.P., a recipient of payments from Virginia Electric and Power Company that were the subject of the case below. The parent of Richmond Power Enterprise L.P.'s other partner is Entergy Corporation. Richmond Power Enterprise, L.P. has no subsidiaries.

B. Respondent: State Corporation Commission of Virginia

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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1994

HOPEWELL COGENERATION LIMITED PARTNERSHIP, *et al*,
Petitioners,

v.

STATE CORPORATION COMMISSION,
Respondents,

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF VIRGINIA

Hopewell Cogeneration Limited Partnership ("HCLP"), Enron-Richmond Power Corp., ("Enron"), Cogentrix Virginia Leasing Corp. ("Cogentrix"), and Appomattox Cogeneration Limited Partnership ("ACLP") (collectively "Petitioners") respectfully pray that a writ of certiorari issue to review the opinion and judgment of the Supreme Court of Virginia (the "Virginia court") entered in this matter January 13, 1995, rehearing of which was denied by the Virginia court's order issued March 3, 1995.

OPINIONS BELOW

The January 13, 1995 opinion of the Virginia court in Record Nos. 9480885-940888, 940901 and 940902 is reported at 249 Va. 107, 453 S.E.2d 277 and is reproduced in the Appendix to this Petition ("Pet. App.") at 1a-15a. The

January 13, 1995 judgments of the Virginia court in Record Nos. 940885-940888 are not reported but are reproduced at Pet. App. 16a-19a. The March 3, 1995 order of the Virginia court denying Petitioners' petition for rehearing in Record Nos. 940885-940888 is not reported but is reproduced at Pet. App. 20a.

The foregoing orders of the Virginia court were on appeal from Case No. PUE920041 before the State Corporation Commission of Virginia ("SCC"). From the record of that case, the Hearing Examiner's Report issued October 27, 1993 is not reported but is reproduced at Pet. App. 21a-31a, the SCC's Final Order issued February 3, 1994 is reported at 149 P.U.R.4th 136 (Va. 1994) and is reproduced at Pet. App. 32a-74a, and the SCC's Order on Reconsideration issued March 7, 1994 is not reported but is reproduced at Pet. App. 75a-83a.

JURISDICTION

The Virginia court entered its order on March 3, 1995 denying Petitioners' petition for rehearing of that court's opinion and judgment entered January 13, 1995. This Court has jurisdiction under 28 U.S.C. § 1257(a) (1982).

CONSTITUTIONAL PROVISIONS, STATUTES, RULES AND REGULATIONS INVOLVED

This case involves the Supremacy Clause of Article VI of the Constitution of the United States, which is reproduced at Pet. App. 84a, § 210 of the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117, codified as 16 U.S.C. § 824a-3 (1982), which is reproduced at Pet. App. 85a-92a, 18 C.F.R. § 292.304 (1994), which is reproduced at Pet. App. 93a-96a and 18 C.F.R. § 292.602 (1994), which is reproduced at Pet. App. 97a.

STATEMENT OF THE CASE

Section 210 of PURPA, Pub. L. No. 95-617, 92 Stat. 3117, codified as 16 U.S.C. § 824a-3 (1982), was enacted by Congress to encourage the development of certain types of non-utility power generation "qualifying facilities" that efficiently cogenerate electricity and useful thermal energy ("cogeneration facilities") or that use waste or renewable fuels ("small power production facilities").

Under § 210 and the implementing regulations promulgated by the Federal Energy Regulatory Commission ("FERC") and found at 18 C.F.R. Part 292 (1994) [hereinafter PURPA Regulations], electric utilities are required to purchase power from such "qualifying facilities" ("QFs") at a price not to exceed the total incremental cost the utility would have incurred to generate or purchase power from another source, but for the purchase of power from the QF (the utility's "avoided costs"). Total avoided costs are broken down between costs for "capacity" (fixed costs, primarily capital, associated with providing the capability to deliver electric energy) and "energy" (variable costs, primarily fuel and

some operating and maintenance expenses, associated with the production of electric energy). *See* Small Power Production And Cogeneration Facilities, 44 Fed. Reg. 61,190, 61,192 (F.E.R.C. 1979) [hereinafter § 210 NOPR].

Virginia Electric and Power Company ("Virginia Power"), is an electric public utility whose retail rates, facilities and service in Virginia are regulated by the SCC. Virginia Power purchases a portion of its customers' power requirements from NUG facilities under long-term contracts with private owner/operators, including Petitioners. Virginia Power's purchases from NUG producers are the direct result of PURPA § 210.

All of Petitioners' facilities are QFs, which means they receive payments from Virginia Power for dependable capacity and energy the total of which, over the life of the contracts, is calculated not to exceed Virginia Power's total avoided costs for such power. As permitted by FERC's regulations, all of the Petitioners chose avoided cost rates calculated based on Virginia Power's avoided costs estimated as of the time they contracted with Virginia Power.

Petitioners' negotiations with Virginia Power were aided by the fact that, with respect to each of the Petitioners' contracts, Virginia Power's contemporaneous avoided costs for new generation capacity had been administratively determined or otherwise considered and approved by the SCC, FERC or both. Pet. App. at 23a, 27a. In the case of each Petitioner's contract with Virginia Power, the total payments from Virginia Power to the Petitioner do not exceed the level of Virginia Power's avoided costs determined by the SCC or FERC to be just and reasonable for Virginia Power at the time the contract was entered into.

As a matter of policy, the SCC has declined to approve individual contracts, such as those of the Petitioners, larger than those small contracts for which it was required by FERC's regulations to establish "standard offer" rates.[1] Pet. App. at 23a and 4a, n.1.

As the process for determining Virginia Power's avoided costs evolved over time, and as the SCC and other participants in that process gained knowledge, numerous cost inputs and assumptions were removed from and added to the calculation in order to improve it and make it more accurate. Always these improvements and corrections were made prospectively, so as not to disturb existing contracts. All such determinations of Virginia Power's avoided costs, beginning with the first such determination in 1981, had included, among thousands of data inputs, a cost for gross

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[1]To a limited extent, the SCC has approved QF contracts as an arbitrator when Virginia Power and the QF could not agree on terms and conditions, including the proper level of avoided cost payments. Pet. App. at 23a. The capacity payments approved by the SCC for Virginia Power in one such arbitration were partially disallowed by the North Carolina Utilities Commission for exceeding avoided cost, which spawned litigation confirming that the issues raised in this Petition are not limited to Virginia. *State ex rel. Utilities Comm'n v. North Carolina Power*, 338 N.C. 412, 450 S.E.2d 896 (1994), *reh'g denied* 339 N.C. 621, 454 S.E.2d 269 (1995), *petition for cert. filed sub nom. North Carolina Power v. State of North Carolina ex rel. Utilities Comm'n*, No. 94-1868, 36 U.S.L.W. 3834 (May 15, 1995). The SCC also has approved avoided cost rates for QFs under Virginia Power's "standard offer" Schedule 19, but does not consider the same rates paid to Petitioners under contemporaneous agreements to have been approved by the SCC, even where they were the subject of arbitration. Pet. App. 23a, 27a-28a, 68a, 10a.

receipts taxes ("GRT") payable by Virginia Power.[2] Pet. App. 4a, 23a-24a. The avoided cost rates paid by Virginia Power to QFs, including Petitioners, were approved by the SCC for rate recovery in every Virginia Power rate proceeding since such payments began in 1981 until SCC Case No. PUE920041, which gives rise to this Petition.[3]

Virginia Power initiated Case No. PUE920041 when it filed an application on May 29, 1992 requesting the SCC to grant an increase in electric rates to recover a proposed annual revenue requirement of $3.3 billion, based on adjusted operating results for 1991. Pet. App. at 32a. This request included recovery of capacity and energy payments to NUG producers, including Petitioners. The SCC's Staff proposed, among other accounting adjustments, that the Commission disallow Virginia Power's rate recovery of the portion of the utility's capacity payments to NUGs under existing contracts attributable to inclusion of GRT. The Staff testified that GRT should not be considered an avoided cost because Virginia Power is required to pay GRT whether the power it sells is purchased from a NUG facility or generated by Virginia Power. Pet. App. at 64a-65a.

The Staff argued in Case No. PUE920041 that inclusion of GRT in capacity payments was an "error" causing the

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[2]This GRT component was in Virginia Power's computer model for estimating the capacity payment portion of its avoided costs. The facts do not clearly indicate that all of Petitioners' rates negotiated with Virginia Power actually included an ascertainable GRT component.

[3]ACLP's power purchase agreement with Virginia Power dates to 1981. The agreement between the Cogentrix QF and Virginia Power was executed in 1986. The agreements between the HCLP and Enron QFs and Virginia Power both date to 1987.

payments to exceed Virginia Power's avoided costs and that the amount of these payments recovered through rates should be reduced accordingly. Pet. App. at 65a. The Staff made no attempt to determine whether Virginia Power's payments to any NUG producers actually exceed Virginia Power's applicable total avoided cost by investigating whether inclusion of GRT should be offset because others of the thousands of inputs should have been increased or because other inputs should have been added. The Staff merely proposed to disallow the GRT component of each capacity payment.

The Staff originally recommended that the SCC disallow the GRT component of payments to all 58 NUG producers receiving capacity payments, including Petitioners, for a total proposed disallowance of $4.2 million annually. Pet. App. at 24a.[4] The Staff's proposal had a direct impact on Petitioners and other NUG producers, because their contracts with Virginia Power contain so-called "regulatory out" provisions which give Virginia Power the opportunity to recover from the producer amounts paid by Virginia Power but which Virginia Power cannot recover through its rates due to lawful regulatory action. Pet. App. at 8a, 24a, 67a.

Once they learned of the Staff proposal, many affected NUG producers, including Petitioners, appeared before the SCC to oppose the Staff on this issue. Pet. App. at 21a. The Staff revised its proposal to exempt 40 of the NUG producers with GRT-affected capacity payments. Pet. App. at 24a-26a. This left 18 NUG producers, including the

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[4]The GRT-affected portions were approximately 2% of each producer's capacity payments.

Petitioners, subject to annual disallowance of $2.6 million.[5] Pet. App. 26a. However, the stipulated evidence showed that Virginia Power's payments to each of Petitioners were equal to or less than its payments to other NUG producers with the same avoided costs but whose payments would exempted from disallowance under the Staff's revised proposal. Pet. App. at 10a.

A hearing was held before a Hearing Examiner, at which all of the evidence was stipulated. Pet. App. at 21a-22a. Petitioners argued that the Staff's disallowance proposal violated § 210 of PURPA and the PURPA Regulations implementing the PURPA avoided cost standard because the Staff had failed to show that Petitioners' payments exceeded Virginia Power's avoided cost as those regulations require avoided cost to be determined. Pet. App. at 7a. After receiving the evidence and argument, the SCC's Hearing Examiner issued a report recommending to the Commission that the Staff's revised proposal be rejected on the grounds that it would be "unjust, unfair and arbitrary" to exempt some producers from the effect of this proposal and penalize others by including them, when all had relied on previous determinations of Virginia Power's avoided cost at levels that included the GRT component. Pet. App. at 27a-28a. In their comments to the SCC on this Report, the Petitioners restated their argument that the Staff proposal violated PURPA § 210 and the PURPA Regulations.

In its Final Order issued February 13, 1994, the SCC rejected the Hearing Examiner's recommendation and

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[5]The Staff's revised proposal exposed the Petitioners to a total of $1.9 million of disallowance annually, or 75% of the total of $2.6 million for all 18 NUGs.

adopted the Staff's revised proposal. Pet. App. at 65a-66a. The SCC found that inclusion of GRT in the capacity payments to all of the NUG producers in question was an "error" in the calculation of avoided cost, thereby producing costs that were "unnecessary and excessive." Pet. App. at 6a, 39a, 64a-69a. However, the SCC imposed the burden of its action on only 18 of the NUG producers, including Petitioners, by exempting 40 NUG producers on the grounds that their payments had been previously approved by the FERC or by the SCC itself. Pet. App. at 25a-26a, 67a-68a. Attempts to persuade the SCC to reconsider its action were rejected in its Order on Reconsideration issued March 7, 1994. Pet. App. at 75a-83a.

Petitioners, another NUG producer and Virginia Power took appeals of right from the SCC's Final Order and Order on Reconsideration in Case No. PUE920041 to the Virginia court. The Petitioners argued on appeal that the SCC was required by PURPA § 210 to implement the federal avoided cost standard as specified in the PURPA Regulations but had failed to do so and further that the SCC was preempted, as a matter of federal law under that statute, from disallowing the GRT-affected portion of Virginia Power's capacity payments to Petitioners. Pet. App. at 7a.

The Virginia court issued its opinion on January 13, 1995, affirming the SCC. The court held that "[T]he rate a utility pays a non-utility generator is regulated, at least in part, by federal statute and regulations." Pet. App. at 3a. The court also acknowledged that "[A]voided cost rates cannot be calculated with precision . . . [because] [T]hey depend on a number of assumptions, data inputs, estimates, and calculations." *Id.* The Virginia court further recognized that under § 292.304(b)(5) of the PURPA Regulations avoided

cost rates do not conflict with PURPA if they differ from actual avoided cost at the time of delivery. *Id.*

Nevertheless, the Virginia court held that the SCC had properly exercised its ratemaking duty under principles of state law to rectify an "error" in the avoided cost determination that produced "unnecessary and excessive" capacity payments because "including a GRT component in the avoided cost rate calculation makes the rate higher than it otherwise would have been." Pet. App. at 6a,10a. The Virginia court further held that § 292.403(b)(5) of the PURPA Regulations "does not support appellants' conclusion that once a contract is executed, the components of an avoided cost rate are insulated from regulatory review in a rate setting proceeding." Pet. App. at 7a-8a. Finally, the Virginia court held that the SCC was only required to act under state law, and was not subject to the requirements of PURPA, in determining whether Virginia Power's payments to QFs exceeded avoided cost:

> Nothing in the language of PURPA or the regulations supports the appellants' view of the role of a state public utility commission in a ratemaking proceeding. In this case, the Commission was not considering whether an avoided cost rate contained in a purchased power contract complies with the requirements of PURPA or related federal and state regulations. *Cf. West Penn Power Co. v. Pennsylvania Pub. Util. Comm'n*, 623 A.2d 383 (Pa. 1993). In this case, the Commission was required to evaluate the reasonableness of an expense to determine whether that expense can properly be recovered from the utility's ratepayers. The principles applicable here are those relating to setting utility rates and are well established under state law.

Pet. App. at 9a.

Petitioners filed a Petition for Reconsideration arguing that the Virginia court's opinion was in conflict with and preempted by PURPA and the PURPA Regulations and with recent decisions of the United States courts of appeal and the FERC construing that statute and those regulations. The Virginia court's judgment denying that petition was issued on March 3, 1995.

REASONS FOR GRANTING THE WRIT

PURPA § 210 has been the primary reason for the emergence of competition into the electric industry, because it established a national policy of encouraging the development of alternative, non-utility sources of power generation. The decision below would thwart that policy by using state law regarding regulation of electric utility rates to undermine the encouragement which Congress intended to give QFs, by assuring them of rate stability, in order to make that competition a reality.

Recent litigation in the courts and before the FERC indicates that there is significant uncertainty within the electric industry regarding the issues presented in this Petition. Recent opinions of the United States Courts of Appeals for the Ninth Circuit and Third Circuit, as well as a series of recent decisions by the FERC, contain holdings with respect to the states' implementation of PURPA § 210 that directly conflict with the judgment of the Virginia court below.

The conflicts between the holdings of these federal decisions and those of the Virginia court are not merely of

academic interest. They raise the question whether a federal policy of major importance to the energy markets, which has produced significant economic benefits for consumers, will be properly implemented at the state level.

Only this Court can provide the guidance needed on these key issues of preemption as the FERC, state regulators and the federal and state courts struggle with the future restructuring of the electric industry brought by the competition produced by PURPA § 210.

A. Virginia Has Interfered With Federal Law And Policy

The FERC began its recent, historic proposed rulemaking on open-access power transmission with the following description of the new competitive marketplace for wholesale electric power and its benefits for consumers:

> The electric power industry is today an industry in transition. In response to changes in the law, technology, and markets, competitive pressures are steadily building in the industry. Once the primary domain of large, vertically integrated utilities providing power at regulated rates, the industry now includes companies selling "unbundled" power at rates set by competitive markets. New generating facilities are being built at costs well below the average costs of some vertically integrated utilities. In this environment, more competition will mean lower rates for wholesale customers and, ultimately for consumers.

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services By Public Utilities, 60 Fed. Reg. 17,662 (F.E.R.C. 1995).

The mandatory purchase requirement of PURPA § 210 created the independent power generation industry, thereby proving that traditional, vertically-integrated public utilities need not be the only sources of reliable power and introducing the first significant competition into the wholesale power markets. 60 Fed. Reg. 17,670; Santa and Sikora, *Open Access and Transition Costs: Will the Electric Industry Transition Track the Natural Gas Industry Restructuring?* 15 Energy L.J. 273, 291-292 (1994) [hereinafter *Open Access and Transition Costs*].

In § 210 the Congress required the FERC to prescribe "such rules as it considers necessary to encourage cogeneration and small power production," including rules requiring electric utilities to purchase electric power from QFs. Pet. App. at 85a-92a. *See American Paper Inst., Inc. v. American Elec. Power Serv. Corp.*, 461 U.S. 402, 412-418 (1983) [hereinafter *API*] (upholding FERC's regulations requiring utilities to purchase electricity from QF at full avoided cost as reasonable in order to provide "maximum incentive for development of cogeneration and small power production").

The PURPA Regulations were developed by FERC to fulfill the mandate of §210 and were issued in 1980 by FERC Order No. 69. Small Power Production And Cogeneration Facilities, 45 Fed. Reg. 12,214 (F.E.R.C. 1980) [hereinafter Order 69]. They provide that electric utilities must purchase electric energy and capacity made available by qualifying facilities at rates not to exceed the purchasing utility's full avoided costs of such capacity and energy. *Id.* at 12,215; 18 C.F.R. §§ 292.303 and 292.304 (1994); *see also Federal Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 742, 759-760 (1982) (upholding constitutionality of PURPA § 210)

and *API*, *supra*. The FERC defined "avoided costs" in the PURPA Regulations to mean "the incremental costs to an electric utility of electrical energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101 (1994). Therefore, where capacity and energy are being purchased from the QF, the utility's "avoided cost" is the total of its avoided costs for capacity and energy.

The QF has the option under § 292.304(d) of the PURPA Regulations to choose whether the "avoided costs" are estimated as of the time the utility's obligation to purchase was established or as of the time the QF delivers the power. Pet. App. at 94a-95a. In order to reconcile the requirement that payments to QFs not exceed the utility's avoided cost with the need for QFs to be able to enter into contractual commitments based on estimates of those avoided costs, § 292.304(b)(5) of the PURPA Regulations provides that, where such payments are based on estimated avoided costs, they do not violate PURPA if they differ from actual avoided costs at the time the power is delivered.[6] Pet. App. at 93a-94a.

In the § 210 NOPR, which served as the basis for Order 69, the FERC stated clearly that §§ 292.304(b)(5) and 292.304(d) of the PURPA Regulations were intended to encourage development of QFs and not to require mathematical precision in estimating avoided costs:

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[6]The SCC never determined whether Virginia Power's payments to Petitioners, with or without GRT, differed from Virginia Power's actual avoided cost.

> So long as a rate for purchases reasonably accounts for the avoided costs, and does not fail to provide the required encouragement of cogeneration and small power production, it will be considered as implementing these rules.
>
> * * *
>
> The Commission believes these potential deviations are a normal result of risk allocation resulting from contractual commitments or other legal obligations, and believes that they must be permitted if the Commission is to fulfill its mandate to encourage cogeneration and small power production.

44 Fed. Reg. 61,195 and 61,196.

Order 69 makes it clear that the purpose of the policy is to carry out the intent of PURPA §210 -- to encourage the development and sale of power from QFs:

> Paragraphs (b) (5) and (d) are intended to reconcile the requirement that the rates for purchases equal the utilities' avoided cost with the need for qualifying facilities to be able to enter into contractual commitments based, by necessity, on estimates of future avoided costs.
>
> * * *
>
> Many commenters have stressed the need for certainty with regard to return on investment in new technologies. The Commission agrees with these latter arguments, and believes that, in the long run, "overestimations" and "underestimations" of avoided costs will balance out.

45 Fed. Reg. 12,224. *See also* Administrative Determination Of Full Avoided Costs, Sales Of Power To Qualifying Facilities, And Interconnection Facilities, 53 Fed. Reg.

9,331, IV F.E.R.C. Proposed Regulations ¶ 32,457, at 32,171-173.

Pursuant to § 210(f) of PURPA, the FERC also determined in Order 69 that its regulations with respect to the development of payments to qualifying facilities, the determination of avoided costs and the enforcement and overall implementation of those regulations were to be carried out by the state regulatory authorities, such as the SCC. 45 Fed. Reg. 12,230-231. But in discharging these responsibilities the states are required as a matter of federal law to carry out PURPA's mandate to promote QF development. The FERC stated in Order 69 that "[S]tate laws or regulations which would provide rates lower than the federal standards would fail to provide the requisite encouragement of these technologies, and must yield to federal law." *Id.* at 12,221.

Under PURPA § 210(e) and § 292.602(d) of the PURPA Regulations, the states are also prohibited from subjecting QFs or their rates to utility-type regulation. Pet. App. at 87a-89a, 97a.

Thus, the PURPA Regulations establish that, in order to provide the required encouragement, payments to QFs can be based on reasonable estimates of utility avoided costs and such payments do not violate PURPA if they differed from the utility's actual avoided costs at the time the power is delivered. Otherwise, there would not be sufficient revenue stability to encourage investment in these new, alternative sources of power generation. That encouragement succeeded in producing a viable market for independent power generation and "sowed the seeds of the competitive

generation market that sprouted in the 1980s." *Open Access and Transition Costs*, *supra*, at 291.

B. The Opinion Below Creates A Conflict With Decisions In The Federal Courts Of Appeal And Regulatory Agencies

This case concerns the SCC's implementation of PURPA's avoided cost standard. Recent decisions by the United States Courts of Appeal for the Ninth Circuit and Third Circuit, as well as a series of recent decisions by the FERC, contain holdings that delineate a state commission's authority when reviewing avoided cost payments by a utility. Although Petitioners argued these federal cases to the Virginia court, that court declined to apply them.[7]

1. Other Courts Have Reached A Contrary Result

In the Ninth Circuit case *Independent Energy Producers Ass'n, Inc. v. California Public Utilities Comm'n*, 36 F.3d 848 (9th Cir. 1994) [hereinafter *IEPA*], a trade association of NUG producers sought to enjoin the California Public Utilities Commission ("CPUC") from implementing a program allowing utilities purchasing power from QFs to reduce their avoided cost payments under "standard offer" contracts previously approved by the CPUC. The CPUC program authorized each utility to make such reductions in

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[7]The decisions in these cases were issued after briefs were filed with the Virginia court but the Ninth Circuit decision was lodged with the Virginia court before oral argument, and discussed in that argument, and both decisions were argued in Petitioners' petition to the Virginia court for rehearing.

its avoided cost payments if the utility determined that the QF had not complied with certain federal operating and efficiency standards as required under PURPA to qualify as a QF. The federal district court granted summary judgment for the CPUC. The Ninth Circuit reversed, holding that the CPUC was preempted from imposing on the QFs a rate less than "full avoided cost" required by § 292.304(d) of the PURPA Regulations in order to maximize the development of cogeneration and small power production. 36 F.3d 858 (citing IV F.E.R.C. Proposed Regulations at 32,158).

The Ninth Circuit also rejected the CPUC's claim that the reduced avoided cost payments were necessary for the rates to be "just and reasonable and in the public interest" as required by PURPA § 210 and § 292.304 of the PURPA Regulations, because the utilities' actual avoided costs were less than those on which the payments were based. Rather, the federal court noted that the FERC had considered this possibility but had determined that "certainty as to rate was important" to the encouragement of QF development. *Id.* at 848 (citing 45 Fed. Reg. 12,224). The court further stated that the CPUC's remedy for demonstrated disparity between estimated and actual avoided costs is not to affect existing contract rates but to require more flexible pricing provisions in future contracts. *Id.* at 859.

In the Third Circuit case *Freehold Cogeneration Associates, L.P. v. Board of Regulatory Comm'rs*, 44 F.3d 1178 (3d Cir. 1995), *reh'g denied en banc* March 7, 1995 [hereinafter *Freehold*], a QF sought a declaratory judgment that PURPA preempted the New Jersey Board of Regulatory Commissioners ("BRC") from requiring the QF and the purchasing utility to renegotiate the avoided cost rates contained in an existing power purchase agreement

previously approved by the BRC, or to agree on terms for a buy-out. The BRC had taken this action because the utility's avoided costs had declined since the agreement had been negotiated. The federal district court granted the BRC's motion to dismiss, based in part on lack of jurisdiction.

Upon finding that the federal courts had jurisdiction, the Third Circuit reversed the district court on the ground that, once the BRC had approved the avoided cost rates, "any action or order by the BRC to reconsider its approval or to deny the passage of those rates to [the utility's] consumers under purported state authority was preempted by federal law." *Id.* at 1194. The court concluded that the language in PURPA § 210(e) and § 292.602(c) of the PURPA Regulations exempting QFs from state "utility-type" regulation means that, once a state exercises its limited authority under PURPA § 210(f) to review an avoided cost determination for consistency with PURPA and the regulations, the QF's avoided cost rate is no longer subject to state review. *Id.* at 1192-1193.

This holding is consistent with the result in *Smith Cogeneration Management, Inc. v. Corporation Comm'n*, 863 P.2d 1227 (Okla. 1993) [hereinafter *Smith*], cited with approval by the *Freehold* court, which held that PUC reconsideration of long-term contracts with established estimated costs imposes utility-type regulation over QFs that is prohibited by the PURPA Regulations. 44 F.3d 1192-93. It is further consistent with the fact that, but for the exemption from federal rate regulation provided to QFs by § 292.601(c) of the PURPA Regulations, the states would be preempted by the "filed rate doctrine" from any involvement in the development of wholesale rates paid by utilities to QFs and would be prohibited from disallowing passthrough to

consumers. *See Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986); *accord* Connecticut Light & Power Company, 71 F.E.R.C. ¶ 61,035, at 61,153 (order denying reconsideration) (1995).

Freehold also addressed an additional issue related to this Petition. The BRC had argued that the "regulatory out" clause in the agreement constituted a waiver by the QF of its rights under PURPA to be free from state utility-type regulation. The Third Circuit held that this provision in the contract merely described what would happen if the purchasing utility lost its right to pass its payments on to consumers but did not confer on the BRC any jurisdiction it did not otherwise have, nor did it surrender any of the protection from state regulation conferred upon the QF by PURPA. 44 F.3d at 1194.

In sum, the Virginia court's decision creates the following conflicts:

- The rate a utility pays a QF is not, as the Virginia court held, "regulated, *at least in part*, by federal statute and regulations," and state law principles of utility regulation may not be invoked, as they were by the SCC and the Virginia court, to frustrate Congress' intent to encourage the development of QFs. Pet. App. at 3a (emphasis added). *IEPA* and *Freehold* confirm that the avoided cost standard is *entirely* a matter of federal law, to be implemented by the states only in accordance with the requirements of PURPA and the PURPA Regulations.

- *IEPA* and *Freehold* confirm that PURPA § 210 and the PURPA Regulations preempt a state PUC from reducing avoided cost payments to a QF below the utility's full

avoided cost, whether such reduction is accomplished directly through reconsideration of the contract under which the QF sells power to the purchasing utility or indirectly by disallowing passthrough of the avoided cost rates to the utility's consumers.[8] 36 F.3d 858-859 and 44 F.3d 1194. The Virginia court reached a conflicting holding that the SCC's ratemaking jurisdiction under state law gave it the authority to review and disallow utility rate recovery of payments to QFs under existing contracts.[9] Pet. App. at 9a-11a.

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[8]PURPA not only entitles a QF to receive a certain payment, but it also requires the utility to make the same payment. If a utility is required under federal law to make the payment, state utility law cannot be used to prevent the utility from recovering that payment from its customers.

[9]Although the state in *IEPA* and *Freehold* had approved the individual contracts in issues, the SCC had a policy against approving the individual QF contracts at issue here. *See supra* note 1. However, the stipulated evidence of Petitioners in Case No. PUE920041 showed that, with respect to each Petitioner's QF, the payments received did not exceed the contemporaneous full avoided cost for capacity and energy approved by the SCC for Virginia Power and applicable to such QF. According to the Virginia court, and the SCC in Case No. PUE920041, the Petitioners cannot claim the benefits of these SCC determinations of Virginia Power's avoided costs unless Petitioners' agreements with Virginia Power were specifically approved by the Commission. Pet. App. at 10a-13a. Of course, this reasoning of the SCC and the Virginia court is circular because the SCC's policy has been *not to approve* such agreements. In any event, under the holdings of *IEPA* and *Freehold* the SCC's attempt to reduce Virginia Power's capacity payments to Petitioners must comply with PURPA whether that attempt constitutes the initial determination or a redetermination of Virginia Power's full avoided cost.

- The opinion in *IEPA* further confirmed that PURPA and § 292.304 of the PURPA Regulations seek to preclude reconsideration of rates in long term QF contracts in order to encourage, by assuring certainty of the rates they would receive, development of QFs as required by § 210. 36 F.3d 858; *accord Freehold*, *supra*, 44 F.3d 1193 (possibility that rates in QF contract will be reconsidered recognized as obstacle to obtaining financing for project, citing *Smith*, *supra*). These holdings are in conflict with the Virginia court's claim that the components of avoided cost are always subject to review in a state rate proceeding. Pet. App. at 9a-11a.

- The requirement of PURPA § 210 that the development of QFs be encouraged also was the basis for the conclusions in the *IEPA* and *Freehold* opinions that any remedy for inaccurate avoided cost estimates should operate prospectively only and should not affect existing contracts. 36 F.3d 859 and 44 F.3d 859; *accord* Connecticut Light & Power Company, *supra*, at 61,154. The Virginia court's conflicting holding that existing contracts may be affected by the SCC in a state rate proceeding raises precisely the specter of instability the PURPA Regulations seek to avoid.

- The Virginia court sought to justify its decision in part on the supposition that the presence of a "regulatory out" clause in a QF contract indicated that the QF contemplated the type of disallowance of rate recovery made by the SCC in Case No. PUE920041. Pet. App. at 8a, n.4. However, the Ninth Circuit in *Freehold* held that the presence of such a provision in an avoided cost contract does not change PURPA, operate to waive a QF's PURPA rights, or

expand state commission authority over a QF. 44 F.3d at 1193-1194.

- Under the PURPA Regulations, where capacity and energy are to be sold, the payments to a QF satisfy the federal avoided cost standard if the *total* payments for *capacity and energy* over the life of the contract do not exceed the utility's *total* avoided cost for such *capacity and energy* over the same period. 44 Fed. Reg. 61,192; 45 Fed. Reg. 12,216; IV F.E.R.C. Proposed Regulations at 32,163-164 and 32,170. Under *IEPA* and *Freehold*, the SCC was preempted from finding, as it did, that Virginia Power's *capacity payments* to Petitioners exceeded Virginia Power's avoided costs due to inclusion of a GRT component, without making any attempt to compare total payments for capacity and energy with total avoided costs.

- Under the holding of *IEPA*, the SCC could not diverge from PURPA and the PURPA Regulations in determining whether Petitioners' payments from Virginia Power exceed the utility's avoided cost. 36 F.3d 889. The Virginia court found that a capacity payment that includes a GRT component exceeds "true avoided cost" because inclusion of GRT, which was found by the SCC not to be an avoided cost, "makes the rate higher than it would have been without it." This is a non-sequitur. A level of cost cannot be said to be "excessive" except by comparison to some other level of cost. Rather than make such a comparison between Virginia Power's total payments to a Petitioner for capacity and energy and an approved level of total avoided cost, as required by PURPA and the FERC's regulations, the SCC simply isolated and removed one of the thousands of inputs to the avoided cost calculation. The Virginia court's finding that the SCC's action does not conflict with

PURPA cannot be reconciled with the holdings in *IPEA* and *Freehold*. *Accord West Penn Power Co. v. Pennsylvania Pub. Util. Comm'n*, 623 A.2d 383, 387-388 (Pa. Commw. 1993) (PUC required to examine all elements of avoided cost to determine correct calculation, as opposed to correcting one element found to be erroneous) [10]

2. Recent Litigation Before The FERC Shows That The Decision Below Is In Conflict With Longstanding Federal Regulatory Authority

PURPA § 210's mandatory purchase obligation helped create competition in the electric industry. The evolution of the industry into a fully competitive marketplace has been accompanied by a recent flurry of litigation before the FERC brought by parties to QF contracts seeking clarification of the preemptive effect of § 210 on the states' implementation of the avoided cost standard. All of the stakeholders in the electric industry -- utilities and their

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[10]It also conflicts with FERC's conclusion in CGE Fulton, L.L.C., 70 F.E.R.C. ¶ 61,290 (1995) that all elements making up state-mandated utility payments to a QF must be considered, including an offsetting tax credit, to determine whether avoided cost has been exceeded. It is further inconsistent with FERC's policy that wholesale rates ordinarily should be adjusted only upon a comprehensive review of estimated utility cost-of-service data, unless a "spot adjustment" of a single item is necessary because challenged estimates are shown to have been "unreasonable" when made or are proved to be "substantially" in error because of subsequent events. *See Carolina Power & Light Co. v. Federal Energy Regulatory Comm'n*, 860 F.2d 1097 (D.C. Cir. 1988) and *Southwestern Public Serv. Co. v. Federal Energy Regulatory Comm'n*, 952 F.2d 555, 558 (D.C. Cir. 1992) (construing FERC decision not to make spot adjustment as having been based on conclusion that 2% change in tax rates was not "substantial").

regulators, customers and investors, as well as NUG developers, operators and investors -- would benefit from the guidance provided by a decision from this Court on the issues raised by this Petition, particularly where, as here, the state position is in conflict with recent federal regulatory pronouncements.

Connecticut Light and Power Company, 70 F.E.R.C. ¶ 61,012 (1995), reconsideration denied, 71 F.E.R.C. ¶ 61,035 (1995), appeal docketed *sub nom., Niagara Mohawk Power Corp. v. FERC*, No. 95-1222 (D.C. Cir. Apr. 24, 1995) [hereinafter Connecticut Case], involved the Connecticut Municipal Rate Statute, which required electric utilities to purchase power from a trash-to-energy facility owned and operated for the benefit of a municipality at the same rate that the electric utility charges the municipality for electricity. An electric utility petitioned for a declaratory order from the FERC that the statute is preempted by PURPA § 210 because the rate prescribed by the statute may exceed avoided cost. The FERC granted the petition, ordering that, "insofar as the Municipal Rate Statute at issue here may require rates for sales by QFs that exceed avoided cost, the statute is to that extent preempted." 70 F.E.R.C. at 61,031. In reaching that conclusion, the FERC engaged in the following analysis of the preemptive effect of PURPA § 210:

> For QFs, jurisdiction over rates for sales at wholesale is vested in this Commission. PURPA expressly directed this Commission, and not the states, to prescribe rules governing QF rates. PURPA gave the states responsibility *only* for "implement(ing)" the Commission's rules. [footnote omitted, citing *IEPA*] That is, a state may prescribe

> a particular per unit charge only if it does so in accordance with the Commission's rules.

Id. at 61,027-028. The FERC stated further that "the appropriate time to challenge a state-imposed rate is up to or at the time the contract is signed, not several years into a contract which heretofore has been satisfactory to both parties." *Id.* at 61,029.

The FERC's order in the Connecticut Case fostered a series of other cases in which the preemptive effect of PURPA § 210 was addressed. In Southern California Edison Co., 70 F.E.R.C. ¶ 61,215 (1995) [hereinafter California Case], two utilities challenged the CPUC's Biennial Resource Plan Update on the grounds that they were being required to contract to purchase power from QFs at rates that exceed their avoided costs. The FERC agreed, finding that the CPUC's "procedure could not properly determine avoided cost, because it excluded potential sources of capacity from which the utilities could purchase." 70 F.E.R.C. at 61,677. The FERC acted in its role of "ensuring [that] the process used to calculate the per unit charge (i.e., implementation) accords with [PURPA] and [its] regulations." *Id.* at 61,678. The FERC also expressed "grave concerns" regarding the need for the capacity and the staleness of the data used. *Id.* However, the FERC stated that its order should not be construed to invalidate unchallenged, preexisting contracts in California or elsewhere, stating that "the appropriate time in which to challenge a state-imposed rate for a QF purchase is up to the time the purchase contract is signed, not years into a contract." *Id.*

CGE Fulton, L.L.C., 70 F.E.R.C. ¶ 61,290 (1995) involved an Illinois statute similar to the statute considered in the

Connecticut Case. The Illinois law required the Illinois Commerce Commission to direct utilities to purchase power from certain municipal solid waste energy facilities at the average rate paid by the municipal operator, but also provided a tax credit to the utility equal to the difference between the rate paid by the utility and its avoided cost. A QF sought a declaratory order that the Illinois statute did not violate PURPA § 210. The FERC found that it did not, because the flowback of the tax credit meant that the amounts above avoided cost are paid by the taxpayers, not by the utility and its ratepayers, who are required ultimately to pay a rate equal to avoided cost. 70 F.E.R.C. at 61,844.

The most recent of these cases involved unsuccessful attempts by utilities to argue that FERC's orders in the Connecticut and California Cases meant that utilities with executed QF contracts containing rates based on avoided cost estimates made at the time of the contracts were not obligated to pay those rates where the actual avoided costs were different. New York State Electric & Gas Corporation, 71 F.E.R.C. ¶ 61,027 (1995) and West Penn Power Company, 71 F.E.R.C. ¶ 61,153 (1995), 1995 WESTLAW 265343 (F.E.R.C.). FERC rejected those claims primarily for two reasons. Section 292.304(b)(5) of the PURPA Regulations expressly permits rates based on such avoided cost estimates to differ from actual avoided coats at the time of delivery in order to encourage cogeneration and small power promotion as required by PURPA § 210. Second, FERC had stated in the Connecticut and California Cases that it would not disturb existing contracts that were the basis for project financing and under which the parties have been providing and paying for service. 71 F.E.R.C. 61,115 and 1995 WESTLAW

265343, at *12-*13, *16. *Accord* Orange and Rockland Utilities, Inc., 71 F.E.R.C. ¶ 61,034, at 61,146-147.

CONCLUSION

For the foregoing reasons, this Court should grant certiorari and reverse the judgment of the Virginia court.

Respectfully submitted,

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